

## **MEMORANDUM**

From: Gift Tax Subcommittee of Legislative Committee  
of Estate Planning and Fiduciary Law Section of NCBA  
Re: Questions Regarding HB 235/Proposed Revised Bill  
Date: February 28, 2008

**A. Basic Changes Contained in HB 235.** House Bill 235 contains the Revenue Laws Study Committee recommendation to the 2007 General Assembly. It would make the following key changes to North Carolina's gift tax laws:

1. Bill would closely conform North Carolina's gift tax system to the federal gift tax system.
2. Currently, North Carolina gift tax is imposed after allowing for the Annual Exclusion (currently \$12,000.00) and the \$100,000.00 lifetime specific exemption. HB 235 would impose a North Carolina gift tax only when a federal gift tax is due, when taxable gifts exceed \$1,000,000.00.
3. HB 235 would eliminate the current difference in gift tax treatment based on the donor's relationship to the donee. There would be a single rate structure for all taxable gifts.
4. Under HB 235, valuation of taxable gifts for North Carolina purposes would be the same as valuation for federal gift tax purposes.
5. The gift tax rates under HB 235 are the same rates applicable to estates in North Carolina.

**B. Questions Regarding HB 235; Bill to Conform NC Gift Tax to Federal Gift Tax.**

1. HB 235 does not accurately coordinate the imposition of state gift tax with federal gift tax law.
  - (a) Sec.105-32.20(b) of the Bill says that "a gift tax is imposed on a gift when a federal gift tax is imposed on the gift under Section 2501 of the Code . . ." Then Sec. 105-32.20(c) provides the rates of tax on the gift.
  - (b) Under federal law, Sec. 2501 imposes a gift tax and Sec. 2502 sets out the rates of tax and directs that a tentative tax be computed. The tentative tax is computed on the cumulative value of all taxable gifts made during the donor's lifetime, reduced by a tentative tax on the cumulative value of taxable gifts made in prior calendar periods in order to arrive at a tentative tax imposed on cumulative gifts in the current calendar period. Then Sec.

2505 allows a credit against the gift tax imposed, which credit is equal to the tentative tax on the first \$1,000,000.00 of gifts.

- (c) Mechanically, a federal gift tax is “imposed” on the first dollar of gifts after the annual exclusion and then a credit is allowed. To say that a NC gift tax will be “imposed” when a federal gift tax is “imposed” does not make a provision for the credit on the first \$1,000,000.00 of NC gifts.

2. Sec. 105-32.20(c) says that the rates of tax are based on the value of “the taxable gift”. This indicates that the gift tax rate is applied to each taxable gift as opposed to being computed on the basis of cumulative taxable gifts. It is in the interest of the State that the gift tax be applied to gifts on a cumulative basis in a manner similar to the federal gift tax.

3. Sec. 105-32.20(b)(1) appears to impose a gift tax on a NC resident with respect to a gift of real estate or tangible personal property having a tax situs outside of NC. It is questionable whether NC can constitutionally impose a gift tax on property with no situs in NC. In addition, current G.S. Sec. 105-188(a) imposes a gift tax on “all property within the jurisdiction of the State”. Is it intended that the Bill would expand the scope of NC law regarding taxation of property outside of NC?

4. Under Sec. 105-32.20(b)(2)b, NC would impose a gift tax on intangible personal property of a non-resident. This is problematic in that the tax situs of intangible personal property normally follows the residence of the taxpayer.

5. There is no provision for gift-splitting.

6. HB 235 provides no guidance as to the effect of prior gifts or prior gifts tax payments:

- (a) Does each taxpayer start fresh on the effective date of the statute, with the new system applying to gifts made after that date or does the system take into account gifts made prior to enactment?
- (b) Does a taxpayer get a credit for NC gift taxes paid prior to the date of enactment?
- (c) Do NC gifts made prior to date of enactment but covered by the \$100,000.00 specific exemption count as prior gifts made under the new system?

**C. Explanation of Revised HB 235 (As Proposed by the Gift Tax Subcommittee of the Legislative Committee on Estate Planning and Fiduciary Law Section of the NC Bar Association).**

1. Revised HB 235 (Proposed) is based in large part on the Connecticut gift tax statute that specifically incorporates the methodology used in the federal gift tax system to define taxable gifts and to impose a gift tax based on cumulative gifts after allowing for the Annual Exclusion and the Unified Credit.
2. The provisions of HB 235 dealing with what types of property are subject to the gift tax for a resident and for a non-resident were amended to avoid constitutional issues. The revised bill does not attempt to impose a gift tax on the transfer by gift by a resident of real property located in another state. With respect to gifts by nonresidents, the revised bill does not attempt to tax a gift of intangible property because intangible property is viewed as having a situs at the residence of the taxpayer.
3. The provisions of original HB 235 relating to the following subjects were retained in the revised HB 235: rate of tax, valuation, collection of tax, death of donor within three years, due date of return and payment of tax and effect of federal corrections.
4. Original HB 235 did not address the effect of prior gifts or the prior use of the \$100,000.00 specific gift tax exemption. Since the federal gift tax system and the current North Carolina gift tax system compute the gift tax on the basis of cumulative gifts and takes into account prior gifts, Revised HB 235 provides that the new system will compute gift tax by taking into account gifts made and gift taxes paid since January 1, 1948, that being the date currently used in our gift tax statute. Revised HB 235 provides that gifts made after January 1, 1948 will be taken into account except for gifts that were not taxed due to the application of the \$100,000.00 specific exemption.
5. Revised HB 235 provides that it will apply to gifts made on or after January 1, 2008.